Office - Supreme Court, U.S.
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NOV 22 1983
ALEXANDER L. STEVAS,
CLERK

Nos. 83-737 and 83-738

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA and THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Appellants,

v.

UNITED STATES OF AMERICA and WESTERN ELECTRIC COMPANY and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Appellees.

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,

Appellant,

v.

UNITED STATES OF AMERICA and WESTERN ELECTRIC COMPANY and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Appellees.

On Appeal From The United States District Court
For The District Of Columbia

MOTION TO AFFIRM

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QUESTIONS RESTATED

The Modification of Final Judgment ("MFJ") was entered in this case, by consent of the parties, in August, 1982, and summarily affirmed by this Court under the Antitrust Expediting Act in February, 1983. Under the MFJ, the Bell System is now completing a massive reorganization in which it will divest its local exchange operations on January 1, 1984. These appeals present legal challenges to the parties' plan for implementing this reorganization and to the District Court's holding that this plan is "consistent with [the MFJ's] principles and provisions." The questions presented are:

1. Whether direct Supreme Court review of these appeals is "of general public importance in the administration of justice" within the meaning of the Antitrust Expediting Act?

2. Whether the MFJ, which is to be interpreted as a contract between the parties, see, *e.g.*, *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 238 (1975), can be held to have been misinterpreted by the parties who negotiated, drafted, and agreed to it and by the District Judge who entered it?

3. Whether, in any event, the District Court abused its discretion in approving a reorganization plan that achieves the structural reorganization sought by the Justice Department and rests on a careful balancing of the interests of telephone users, competitors in the industry, the Bell System's one million employees, and its three million shareholders?

STATEMENT REQUIRED BY RULE 28.1

Appellee Western Electric Company is a wholly-owned subsidiary of appellee American Telephone and Telegraph Company ("AT&T"). AT&T has no parent company. In addition to its wholly-owned subsidiaries, AT&T has ownership interests in the Southern New England Telephone Company, Cincinnati Bell, Incorporated, and the Cuban American Telephone and Telegraph Company. On January 1, 1984, AT&T will divest seven of its wholly-owned subsidiaries: American Information Technologies Corporation, Bell Atlantic Corporation, BellSouth Corporation, NYNEX Corporation, Pacific Telesis Group, Southwestern Bell Corporation, and U S West, Inc.

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MOTION TO AFFIRM

On August 24, 1982, the District Court, with the consent of the parties, entered the Modification of Final Judgment ("MFJ") in this case. This judgment orders a massive structural reorganization of American Telephone and Telegraph Company ("AT&T") and its subsidiaries ("the Bell System"), which is to occur on January 1, 1984. The appeals from the entry of the MFJ were taken directly to this Court under the Antitrust Expediting Act because the District Court found that legal challenges to the reorganization, no matter how insubstantial, created uncertainty which so

imperiled a vital national industry that the earliest possible final disposition of the appeals was a matter of profound "public importance in the administration of justice." 15 U.S.C. § 29(b). This Court ended this potentially crippling "state of limbo" by deciding the appeals during the 1982 term and summarily affirming the District Court. *Maryland* v. *United States*, 103 S. Ct. 1240 (Feb. 28, 1983).

Now, less than two months before the MFJ is to be implemented, two legal challenges to the reorganization have been filed. These are appeals from the District Court's August 5, 1983, order holding that the parties' plan to implement the MFJ is consistent with its provisions and principles. These appeals, too, were certified to this Court under the Antitrust Expediting Act because the Justice Department urged and the District Court found that the public interest requires final disposition of the challenges to the reorganization before January 1, 1984, and that the nation's need for direct Supreme Court review is now, if anything, more compelling than it was nine months ago.

The only way for this Court to put a timely end to the threats to this vital industry is to decide these appeals under the Antitrust Expediting Act before January 1, 1984. But this need not burden this Court or its docket. The fundamental claim of each of the appellants is that the MFJ has been misconstrued both by the parties who negotiated and drafted it and by the District Judge who entered it. Their contentions are frivolous, and the District Court's decision should be summarily affirmed.

STATEMENT OF THE CASE

Throughout this century, the Bell System has provided integrated, end-to-end telephone service. Its wholly-owned Bell Operating Companies ("BOCs") have franchised monopolies that provide local exchange service. The BOCs own and provide simple and complex telephone instruments ("customer premises

equipment" or "CPE") as well as the wires, cables, and other transmission facilities that run through buildings, streets, and alleys and connect this equipment to local switching facilities. These local facilities originate and terminate long distance calls as well as provide for local exchange calling. The BOCs and the Long Lines Department of AT&T also own and operate interexchange facilities that provide intercity telephone service. The Bell System is technologically integrated; it both manufactures telecommunications equipment for its own use through Western Electric Company and conducts basic telecommunications research through Bell Telephone Laboratories.

In the past four decades, the Justice Department has twice filed civil actions under the Sherman Act which sought major structural reorganizations of the Bell System. In 1949, it filed this action. It led to the entry of a Final Judgment in 1956 which imposed a number of limitations on the services that the integrated Bell System may provide.

In 1974, the Justice Department brought its second action, *United States* v. *AT&T*, No. 74-1698 (D.D.C.). By that time, changes in technology and regulatory policy had introduced competition into major new areas of telecommunications: customer premises equipment, intercity telecommunications service, and emerging information services.[1] However, the provision of local transmission and switching functions not only retained natural monopoly characteristics but entrants in the newly created competitive markets required access to these "bottleneck" facilities to compete effectively. The Justice Department alleged that the Bell System had the opportunity and the incentive to misuse

[1]Technological changes had largely eliminated previous distinctions between regulated telecommunications services and unregulated data processing. These changes not only permitted actual and potential competition between telephone companies and data processing vendors, but also gave rise to claims that the 1956 Judgment prohibited the Bell System from using data processing technologies to enhance its services and, therefore, from continuing its long history of innovation. See J.A. 82 n. 198.

its control over these "essential facilities" to restrain competition in related competitive markets. The Department ultimately sought the divestiture and complete separation of the Bell System's local exchange facilities from its intercity, CPE, and manufacturing businesses. Stipulation Package 82, *United States* v. *AT&T*, No. 74-1698 (D.D.C.). Despite AT&T's vigorous contentions that it had not abused its control of its local exchange monopolies and that the public interest would best be served by maintaining the end-to-end integration of the Bell System, it became increasingly apparent during the pendency of the 1974 case that AT&T's ownership of local exchange facilities would be a source of continuing controversy and uncertainty even if it won *United States* v. *AT&T*.[2]

The Modification of Final Judgment. AT&T concluded that the best way to end the continuing antitrust exposure and to obtain freedom from the obsolete constraints of the 1956 Judgment was to agree to the precise structural reorganization that the Justice Department was seeking in the 1974 case. On January 8, 1982, AT&T and the United States stipulated to the entry of a modification of the 1956 Judgment that would require the divestiture of the Bell System's local exchange facilities and vacate the injunctive provisions of the 1956 Judgment. This modification achieved all the Justice Department's antitrust objectives in its four decades of litigation with AT&T.

When the proposed modification was presented to it, the District Court, with the parties' consent, ordered public interest proceedings—which it conducted with great expedition—that went far beyond the requirements of Antitrust Procedures and Penalties Act of 1974, 15 U.S.C. §§16(b)-(h) ("Tunney Act"). These led to an extensive public examination of the pur-

[2]During this period, the FCC and Congress also debated the issues raised by the 1974 case and the 1956 Judgment, and each considered the adoption of onerous regulations, which would apply to AT&T alone, to minimize or eliminate its alleged incentives and ability to suppress competition through control over local monopolies.

pose, meaning, and effect of each of the proposed modification's provisions.

On August 11, 1982, the District Court held that this proposed reorganization of the Bell System was an entirely appropriate antitrust remedy and manifestly in the public interest, provided several changes were made. See J.A. 1-172. Only two are relevant here. First, the court required the addition of a Section VIII(H) to codify the parties' representations as to the divested companies' capital structures. J.A. 171-72. It provides that the divested BOCs may have debt ratios of no greater than approximately 45 percent, except that in the case of Pacific Telephone and Telegraph Company ("Pacific" or "Pacific Telephone") the debt ratio could be as high as approximately 50 percent.[3] Section VIII(H) further prescribes that the "quality of the debt" of the divested BOCs shall be "representative of the average terms and conditions of the consolidated Bell System debt," but permits exceptions for companies whose current debt "provides a more equitable basis." J.A. 137 n. 321. Second, the District Court required that AT&T's plan for implementing the reorganization be submitted and approved by it, J.A. 172, as well as by the Justice Department. See MFJ, §I(A); J.A. 174.

On August 24, 1982, the District Court, with the parties' consent, entered the MFJ, which contained all the District Court's proposed revisions. On August 26, 1982, the District Court authorized approximately 110 public and private entities and organizations to intervene in this case to appeal the entry of the MFJ, to participate in future District Court proceedings relating to AT&T's plan for implementation of the reorganization, or

[3]During the public interest proceedings, AT&T had shown that Pacific then had a 57% debt ratio because of its adverse local regulatory treatment and financial history and that fairness to AT&T and the other BOCs required that Pacific be divested with a debt ratio of up to approximately 50 percent debt. See, *e.g.*, AT&T Reply Brief, p. 95 n.** (June 24, 1982); see also AT&T Response To Public Comments, pp. 76-77 (May 21, 1982); pp. 23-24, *infra*.

to appeal an order approving that plan. J.A. 191-94. Seventeen intervenors appealed from the entry of the MFJ. On November 10, 1982, the District Court certified these appeals directly to this Court under the Expediting Act, 15 U.S.C. §29(b). This Court summarily affirmed the MFJ on February 28, 1983. *Maryland* v. *United States*, 103 S.Ct. 1240.

Plan of Reorganization. On December 16, 1982, AT&T submitted the 471-page Plan of Reorganization ("Plan") that specified the detailed principles and procedures that will govern the division of the Bell System's resources and the implementation of the divestiture under Section I(A) of the MFJ. See J.A. 174-75.[4]

Two provisions of the Plan are directly pertinent to these appeals. First, because the MFJ splits the telephone network at the interexchange switches, MFJ, §I(A)(2), (4), J.A. 174-75, the Plan assigns the BOCs all the investment in telephone plant located on the exchange side of those switches, including all wires, cables, and transmission facilities and excluding only customer premises equipment. Plan, 6-142. Second, the Plan provides that no BOC will be assigned more debt than the MFJ-prescribed debt ratios would allow and that, when necessary to assure compliance with Section VIII(H), AT&T will assume BOC debt. Plan, 191-97. The Plan also then prescribed that each of the companies would be divested with their existing embedded costs of debt. It explained that any attempts to equalize the costs among companies would introduce improper subsidies among regions, "such as low growth areas subsidizing faster growing areas." Plan, 195. At

[4]On October 4, 1982, AT&T and the BOCs had filed the BOCs' proposals for the division of the country into the exchange areas ("LATAs") and associated independent telephone company territories (see MFJ, §IV(G); J.A. 178-79) that will determine which network facilities are exchange facilities to be divested and which are interexchange facilities to be retained by AT&T. After extensive proceedings, these LATAs were, with minor modifications, tentatively approved in an April 20, 1983, Opinion and finally approved in a decision issued on July 8, 1983. J.A. 284-308.

that time, the regional companies had embedded costs of debt of between 8.5% and 9.1%, with the exception of Pacific Telephone which, due to its adverse financial history (see p. 5 n. 3, *supra*), was then at 9.9%. Plan, 194-95. However, more recent data set forth in the Prospectus that the Bell Companies filed with the SEC on November 16, 1983, indicates that, with the exception of Pacific, the debt ratios of the to-be-divested companies will range from 8.79% (Bell Atlantic Corporation) to 9.4% (Southwestern Bell Corporation). See AT&T Information Statement and Prospectus, pp. 63, 83, 105, 127, 151, 174, 195.

The District Court's Proceedings on AT&T's Plan. The District Court ordered each of the designated Chief Executive Officers of the seven to-be-divested regional companies ("regional CEOs") to submit sworn statements that addressed whether AT&T's Plan of Reorganization will leave them as financially viable companies with the resources necessary "to perform the functions described in the decree" and whether any provision of the Plan was interposed over their objections. See J.A. 164-65. The seven regional CEOs thus each filed affidavits on December 16, 1983. Only one designated CEO directly questioned the financial viability of his region: Donald E. Guinn of Pacific Telephone who raised objections to the treatment of Pacific Telephone's debt.

In response to Mr. Guinn's objections, AT&T, on April 7, 1983, amended the Plan to provide that Pacific would be divested in a more favorable financial position than is required by the MFJ: an expected debt ratio of less than 47%, not the 50% that the MFJ permits, and an average embedded cost of debt expected to be 9.5%. Mr. Guinn thereupon filed a supplemental sworn statement that withdrew his previous objections. See Second Supplemental Statement of Donald E. Guinn (April 7, 1983). This ended the controversy with Pacific.

Under the procedures that the District Court established, some 50 intervenors and *amici curiae* filed comments and objections to the Plan with the Justice Department and with the District Court.

These pleadings raised literally hundreds of issues and addressed virtually every provision of the Plan.

Section I(A)(1) of the MFJ required the Justice Department to conduct an independent examination of the Plan and to approve or to disapprove it. J.A. 174. Thus, after its initial review of the comments, the Department advised AT&T that over 20 amendments had to be made before it could approve the Plan. AT&T formally made 23 separate amendments to the Plan on March 14, 1983, when it filed its Response to Objections to its Proposed Plan of Reorganization ("AT&T's Response"). After reviewing AT&T's Response, the Department on March 24, 1983, submitted the Response of the United States to Public Comments and Action on AT&T's Proposed Plan of Reorganization ("Response of the United States"). It stated that the Department would not formally approve the Plan unless an additional twelve amendments were made. AT&T agreed to each of these amendments.

Notwithstanding the Department's approval of the Plan, as amended, the District Court called for the submission of additional memoranda from the parties, the seven to-be-divested regional companies, and the intervenors on six separate issues. It conducted a hearing on June 2, 1983, in which it heard live testimony from three of the designated regional CEOs. On July 8, 1983, the court issued a 159-page opinion (J.A. 195-330) which concluded that the amended Plan would not be approved unless it were further modified in six major respects—none of which is relevant to these appeals. J.A. 328-330. California thereafter asked the District Court to reconsider its ruling that complex inside wiring was properly assigned to the BOCs. Contrary to California's misstatement (J.S.7), the District Court explicitly addressed and rejected California's complex inside wiring claim, see J.A. 339 n. 18, 343-44, as well as the two other claims raised in these appeals. See J.A. 344 ("station handling"); J.A. 221-22 n. 64 (Pacific debt).

AT&T amended the Plan to adopt the District Court modifications, and the court entered an order approving the amended Plan

on August 5, 1983. J.A. 349-50. The State of California and the California Public Utilities Commission ("California") filed a notice of appeal from this decision on August 10, 1983. The New York State Department of Public Services ("New York") filed a notice of appeal on September 13, 1983.

On August 25, 1983, the Justice Department filed a motion urging the District Court to certify California's appeals and any subsequent appeal from the approval of the Plan directly to this Court under the Antitrust Expediting Act, 15 U.S.C. §29(b). AT&T supported this motion. Neither California, New York, nor any other intervenor opposed it. On September 7, 1983, the District Court issued the certificate, finding that the same basic considerations that dictated direct Supreme Court review of the entry of the MFJ are "equally applicable" here. J.A. 351-54.

REASONS FOR SUMMARY AFFIRMANCE

By directly reviewing the entry of the MFJ last February, this Court recognized that this case has such profound importance for the national economy that it epitomizes the government antitrust actions in which Congress intended direct Supreme Court review of a District Court's final decision. Because a failure to resolve the legal challenges to this reorganization before it occurs on January 1, 1984, would threaten the very success of this massive effort, the considerations that led the Court to review the entry of the MFJ have even greater force now, only weeks before divestiture. These appeals, moreover, present claims that are far less substantial than those as to which the Court affirmed summarily last February. The decision below should be summarily affirmed.

I. EXPEDITION OF THESE APPEALS UNDER THE EXPEDITING ACT IS A MATTER OF PARAMOUNT PUBLIC IMPORTANCE.

In the Antitrust Expediting Act, 32 Stat. 823, *as amended*, 15 U.S.C. §29(b), Congress found that public antitrust cases can have an enormous "impact on the economic welfare of this nation," that they "are unlike other federal cases," and that it is often

necessary and appropriate to expedite the final decision in such cases by making final judgments directly appealable to this Court. H.R. Rep. No. 93-1463, 93d Cong., 2d Sess. 14 (1974); see S. Rep. No. 93-298, 93d Cong., 1st Sess. 3-4 (1973). Although Congress has eliminated the previous requirement that there be direct Supreme Court review in all Government antitrust cases, see 15 U.S.C. §29(a),[5] it retained direct appeals for those Government antitrust cases in which "the district judge who adjudicated the case enters an order stating that immediate consideration of the appeal by the Supreme Court is of general public importance in the administration of justice." 15 U.S.C. §29(b). In such cases, the Act provides that this Court may then either "dispose of the appeal . . . in the same manner as any other direct appeal" or remand it to the appropriate court of appeals, where it will be subject to the ordinary appellate procedures. *Id.*[6]

These appeals present precisely the kind of cases that Congress intended to preserve for direct Supreme Court review. By summarily affirming the entry of the MFJ, this Court recognized that any significant delays in the final resolution of the legal challenges

[5]Congress wished to relieve the Court of the burden of reviewing voluminous records. See S. Rep. No. 93-298, *supra*, p. 8. That is not a consideration here because the question presented is the purely legal question of whether the parties who drafted the MFJ and the District Judge who entered it have misinterpreted it and, even if they have, whether the order approving the Plan represents an abuse of the District Court's discretion.

[6]The Expediting Act, however, was not intended to "bestow on the Supreme Court an unqualified discretion to hear or not hear a case." H.R. Rep. No. 93-1463, *supra*, pp. 13-14 (1974). On the contrary, Congress "intended that the Supreme Court hear cases that are of general public importance in the administration of the antitrust laws." *Id.* The standard for direct appeals is *not* that the case raises novel or unsettled legal issues or is otherwise immediately review-worthy under 28 U.S.C. §1254(1) (Supreme Court review prior to judgment in the Court of Appeals). *Id.* As the District Court stated in its opinion certifying these appeals directly to this Court: "Even though it is not likely that the appeals will present questions of legal significance, they are clearly of general public importance." J.A. 352 (footnote omitted).

to the reorganization of the Bell System create uncertainty that threatens the interests of the Nation. See J.A. 148-49. As the District Court found, the uncertainty that the instant appeals create threatens the same serious adverse consequences; if anything, expedition is even more necessary now because the "January 1 deadline" is only six weeks away and the adverse consequences of continued uncertainty "would be multiplied if the divestiture proceeded on January 1, 1984, while the plan of reorganization was still under challenge in the courts." J.A. 353.

California (J.S. 8-9) and New York (J.S. 8) argue that their appeals raise issues that are discrete and unrelated to other aspects of the reorganization and that delay in the final resolution of their appeals for months or even years after divestiture will have no adverse consequences. As is more fully explained in AT&T's Motion For Expedition Of These Appeals, this is simply incorrect. These challenges implicate the heart of the reorganization. If a decision were issued after divestiture that required a reassignment of complex inside wire, for example, it would disrupt operations, business planning, customer relationships and regulatory decisionmaking and would require post-divestiture reassignments of employees and possible reallocation of BOC debt. Similarly, if California were to prevail on its claim that Pacific's average cost of debt is too high, the embedded debt of the BOCs would have to be pooled and reallocated among the BOCs. Finally, a reversal on any of the grounds raised could also lead the parties to reconsider these and other provisions of the MFJ and Plan, because any significant change in the Plan could destroy the careful balance the MFJ was intended to achieve. The pendency of the appeals, accordingly, creates uncertainty that precludes reliable valuation of any of the to-be-separated companies, impairs access to capital markets, impedes operational decisions, threatens massive post-divestiture disruptions, and prolongs the very interrelationship among Bell System companies that entry and affirmance of the MFJ were supposed to end.

II. THE APPEALS HAVE NO SUBSTANCE AND SHOULD BE SUMMARILY AFFIRMED.

California's and New York's appeals are each frivolous, and the District Court's order approving the Plan of Reorganization should therefore be summarily affirmed. Appellants contend that the three provisions of the Plan—relating to "complex" inside wiring, accounting entries for "station handling", and the average cost of Pacific Telephone's long term debt—violate the MFJ. These contentions are insubstantial on their face. As an antitrust consent decree, the MFJ "is to be construed for enforcement purposes basically as a contract" between the parties to the case, *United States* v. *ITT Continental Baking Co.* 420 U.S. 223, 238 (1975); see *United States* v. *Armour & Co.*, 402 U.S. 673 (1970).

The decisive consideration here is that the challenged provisions of the Plan were drafted to implement the MFJ by one party to the case (AT&T), reviewed and agreed to by the other party (the United States), and were approved as consistent with the MFJ by the District Court following extensive public proceedings. Appellants' contentions thus reduce the untenable claim that an antitrust consent decree can be misinterpreted both by the parties who negotiated it and agreed to it and by the District Judge who entered it after conducting proceedings going beyond those prescribed by the Tunney Act.[7]

Moreover, even if there were a basis for appellants' claim that MFJ has somehow been modified, *sub silentio*, the District Court's decision is reviewable, *at most*,[8] for abuse of discretion.

[7]Because a principal purpose of that Act is to eliminate subsequent disputes over the meaning of antitrust consent decrees, see H.R.Rep. No. 93-1463, 93d Cong. 2d Sess. 8 (1973), the fact that the District Court upheld the interpretations of the parties who drafted and negotiated the MFJ should be conclusive.

[8]This Court has held that where, as here, there is no claim of fraud, lack of jurisdiction, or mistake, a judicial order "rendered by consent [of the parties] is always affirmed without considering the merits of the case." *Swift & Co.* v. *United States*, 276 U.S. 311, 323-24 (1928) (Sherman Act); *accord*, *NLRB* v. *Ochoa Fertilizer Corp.*, 368 U.S. 318, 323 (1961).

See, *e.g.*, *Patterson* v. *Newspaper & Mail Deliverers Union*, 514 F.2d 767, 771-72 (2d Cir. 1975) *cert. denied*, 427 U.S. 911 (1976); *Metropolitan Housing Development Corp.* v. *Village of Arlington Heights*, 616 F.2d 1006, 1015 (7th Cir. 1980). Because the challenged provisions of the Plan promote the Justice Department's antitrust objectives and are manifestly reasonable, neither appellant even claims, much less establishes, that the District Court's discretion was abused.

Appellants' claims, accordingly, can be rejected without even considering the merits of their arguments. However, a detailed examination of their contentions even more vividly demonstrates that there is no basis whatever for holding that the District Court's approval of the Plan was improper.

A. The Plan Properly Assigned The Investment In "Complex" Inside Wiring And "Station Handling" To The BOCs.

California and New York challenge the Plan's assignment to the BOCs of investment in portions of one of the BOCs' accounts, Account 232—Station Connections. California challenges the assignment of "complex" inside wiring and—contrary to its position in the District Court—of all "station handling" costs. In contrast, New York confines its challenge to the treatment of "station handling." Neither claim has any merit.

All of the investment in Account 232 has been incurred for only one purpose: to extend local transmission facilities and connect them to newly installed telephone handsets located on customers' premises. The investment in Account 232 includes the wire that runs from outside the customer's premises through his walls to the standard telephone jack ("simple inside wire"), the wire that runs through walls and floors of skyscrapers and other buildings to connect private switchboards with jacks for the individual telephone handsets ("complex inside wire"), the jacks themselves, and other physical assets. Account 232 "investment" also includes the accounting entries that have been made when tele-

phone company service personnel visit customers' premises to install this wiring, test it, and connect it to handsets or private switchboards. These are "capitalized" labor costs.

The assignment of the entire Account 232 investment to the BOCs follows from the terms and purpose of the MFJ. By its terms, the MFJ splits the telephone network at the point of interexchange switching and provides that all investment on the exchange side of those switches be assigned to the BOCs, with the sole exception of customer premises equipment. MFJ, §§I(A)(2), (4); J.A. 174-75. This is because one of the basic purposes of the MFJ is to separate ownership of the Bell System's interexchange facilities and CPE from its local transmission and switching facilities and thereby to assure that AT&T does not control both an embedded CPE business and "bottleneck" facilities to which all CPE vendors must have access.

Accordingly, in the District Court, both the Justice Department and the trade association of customer premises equipment competitors of AT&T vigorously argued that the facilities in Account 232 must be assigned to the BOCs. Specifically, each argued that the assignment of either "complex" or "simple" inside wire to AT&T would give it control over a facility essential to the CPE business and give it the very opportunity to deny access to CPE competitors that the MFJ was intended to end. See Response of United States, pp. 87-90; Comments of North American Telephone Association, pp. 21-22; *accord*, Kansas Public Service Commission Comments, p. 2.[9] The District Court agreed. It found that both simple and complex inside wire is part of the local

[9]The Department's and the CPE vendors' position flatly refutes California's argument (J.S. 15) that the assignment of inside wire to the BOCs will permit AT&T to "reap excessive profits" or "undercut its competitors" in the CPE market. Whether or not AT&T has a sunk investment for complex inside wiring on its books is irrelevant to its competitive posture. The price AT&T can charge for CPE is dictated by competition. If AT&T tried to charge more than a competitive price for its CPE, customers would turn to other vendors.

exchange "bottleneck" and that assignment of it to AT&T would "insert AT&T-controlled facilities between the Operating Companies and the subscribers, and . . . thus be entirely inconsistent with the basic purposes of the decree." J.A.344. Even if the terms of the MFJ were not so clear, these findings preclude any claim that the District Court abused its discretion in approving this provision of the Plan.

Complex Inside Wire. California acknowledges that the Plan properly assigned "simple" inside wiring to the BOCs. However, of the 110 intervenors in this case, California alone now contends that "complex" inside wiring is somehow different and should have been assigned to AT&T, not the BOCs. It accuses the District Court of having "failed to address" California's contention. (J.S. 7) This is false. The court explicitly held, in ruling on California's own request for reconsideration, that complex inside wiring is part of the "local exchange bottleneck" and that California's position is therefore "entirely inconsistent with the basic purpose of the Decree." J.A.344.

California's arguments boil down to an attempt to rewrite the MFJ. California recognizes that the parties unequivocally intended to assign all inside wiring to the BOCs and that inside wiring was therefore excluded from the MFJ's definition of CPE.[10] Nonetheless, California now makes (J.S. 14-15) two arguments under which complex inside wiring would become CPE. First, California argues that complex inside wire is "equipment employed . . . to route telephone calls" and thus satisfies the MFJ's definition of CPE. MFJ, §IV(E); J.A. 177. But wire transmits

[10]California acknowledges that the parties implemented their intention by incorporating the definition of CPE from the FCC's decision in the *Second Computer Inquiry*, 84 F.C.C.2d 50, 61 n. 10 (1980)—a definition that expressly excludes inside wiring. This definition fixes the meaning of MFJ. The fact that the FCC may hereafter change its definition of CPE, under the different standard of the Communications Act of 1934 (see California J.S. 17 n. 18), is irrelevant to the meaning of the MFJ.

calls; it does not "route" them. This part of the definition of CPE refers only to switching equipment, not to wire. See, *e.g.*, Response of United States, p. 88.

California also argues that complex inside wire should be assigned to AT&T on the theory that it "relates to" CPE within the meaning of Section I(A)(2) of the MFJ. J.A. 174. But, again, the parties have made it explicit that assets "relating to" CPE are confined to those necessary for its installation, sale, or delivery, such as trucks or phone stores. See, *e.g.*, Response of the United States, p. 87, n.*; AT&T's Response, p. 157 n.*. More fundamentally, California's two textual arguments are flatly inconsistent with its proposed distinction between "complex" and "simple" inside wiring and would vitiate the whole MFJ. If complex inside wiring "routes" calls or "relates" to CPE, then so do simple inside wiring, telephone jacks, and even the wire that runs from outside customers' premises through streets and alleys to the BOCs' central offices—all of which epitomize the "bottleneck" facilities that are to be divested and structurally separated from AT&T's CPE business.

Station Handling. In contrast to California, New York acknowledges that the BOCs were properly assigned both the complex and simple inside wiring. However, New York objects to the treatment of a different aspect of Account 232: a portion of the accounting entries that reflect telephone servicemen's "capitalized labor." New York concedes that the major portion of this capitalized labor "investment" represents the servicemen's installation and testing of inside wiring and was properly assigned to the BOCs. However, New York notes that servicemen also perform the function of connecting the inside wire to telephone handsets—known as "station handling"—and New York insists that some portion of the capitalized labor in Account 232 should now be allocated to station handling and assigned to AT&T. Ironically, although California now makes the same argument, it express-

ly disclaimed New York's position in the District Court because of the severe adverse effect it would have on the economic balance that the MFJ was designed to preserve. See also J.A. 339 n. 18.[11]

There is no merit to New York's and California's current claim. Station handling represents the capitalization of labor costs incurred in connecting local transmission facilities to telephone desksets. There is no principled basis for distinguishing this function from any other function whose cost is recorded in Account 232. Station handling is simply the last act in establishing a working station connection.

Furthermore, there is no way to determine what portion of the "capitalized labor" in Account 232 represents time spent in connecting a customer's telephone instrument to local transmission facilities and what portion the time spent testing and installing inside wire or telephone jacks. Telephone company service personnel simply have had no reason or occasion to make an artificial distinction between these interrelated functions and have made no record of the time spent on the respective tasks because the FCC's accounting rules have never made any such distinction. See 47 C.F.R. §31.232. Contrary to appellants' arguments, there is no way to segregate station handling costs from all other costs in Account 232—other than sheer guesswork. The appellants' own arguments vividly demonstrate that any attempt by the District Court to make such "estimates" would introduce into the asset assignment process precisely the valuation proceedings and

[11]In the District Court, California urged only that there be a distinction between complex and simple inside wiring. Because California recognized that the assignment of simple inside wiring and associated station handling "investment" to AT&T would present "special cost recovery problems" for the Bell System's three million shareholders, see California's Further Comments On The Plan Of Reorganization, pp. 20-21 (February 11, 1983), California confined its claim to complex inside wiring. See also California's Reply Comments on the Plan of Reorganization, pp. 25-26 (April 12, 1983) (complex inside wiring "is distinguishable from other elements of Account 232, and so should be transferred to AT&T").

unauditable uncertainty that the MFJ was carefully drafted to avoid.[12] See J.A. 124-33. For these reasons, the District Court found that "there is no practical way to separate out" this part of the capitalized labor entries. This holding implemented the terms and purposes of the MFJ and, in any event, was a sound exercise of discretion.

The appellants' further arguments are meritless. First, New York's argument (J.S.7) that a failure to assign station handling investment to AT&T is anticompetitive rests on a misunderstanding of these accounting entries.

Station handling "investment" is not a physical asset. It is an accounting entry to reflect the fact that, prior to 1981, all the labor costs imputed to the installation of wiring and telephone instruments were not recovered at the time of their installation, but instead were capitalized and recovered through depreciation charges over many years. This occurred pursuant to regulatory policies designed to keep the price of establishing new telephone service artificially low. Beginning on January 1, 1981, the FCC ordered companies to begin recovering all such costs at the time each installation is made, which, under accounting principles, means that the labor costs are "expensed."[13] Because the FCC has ordered that the investment in Account 232 on January 1, 1981, be amortized over 10 years, the Bell System's shareholders' recovery of this pre-1981 investment is nearly 30% complete; the

[12]New York's estimates of the BOCs' station handling "investment" in New York alone vary by a factor of six—from $106 million to $600 million. J.A. 7. New York's suggestion (J.S. 6) that this extraordinary margin of guesswork is typical of the uncertainty in dividing other assets pursuant to the MFJ is wrong. In every other provision of the Plan, whole accounts or subaccounts are assigned, or accounts (*e.g.*, for land and buildings) are divided because records exist that permit the assets to be accurately separated and assigned.

[13]*Amendment of Part 31 (Uniform System of Accounts)*, 85 F.C.C. 2d 818, 819, 823-29 (1981). The FCC gave state regulatory commissions the option of requiring the expensing of all these costs after January 1, 1981, or of phasing in expensing over a four year period.

issue here pertains only to the amounts now in Account 232: *i.e.*, approximately 70% of the capitalized labor costs incurred before 1981.

These accounting entries and regulatory recovery principles are simply irrelevant to post-divestiture competition.[14] For example, there are instances in which two telephones were manufactured in 1980 and are identical in all respects, except one was installed by a BOC in 1980 (with capitalized labor of $60 recorded in Account 232) and the other was installed by a BOC in 1981 (and no entry made in Account 232). Both telephones will be assigned to AT&T on January 1, 1984. Because the two telephones are identical, they will be offered at the same price, and the price that AT&T will be able to charge cannot exceed competitors' prices in the intensely competitive CPE market. It is absolutely irrelevant to AT&T's price—as well as to prices of AT&T's competitors—whether AT&T is also assigned the entire sunk "investment" in Account 232 for the telephone installed in 1980. It is equally irrelevant to post-divestiture competition whether AT&T is assigned that portion of the total "capitalized labor" in Account 232 that may be estimated to represent "station handling."[15]

Second, appellants argue that assigning the disputed parts of Account 232 to the BOCs will unfairly burden regulated rate-

[14]California's related argument that the Plan's assignment of station handling to the BOCs permits AT&T to obtain CPE at less than its full cost is even more fundamentally erroneous. First, it ignores that the reorganization of the Bell System is not a sale of assets, but a split of a single enterprise's assets in which purchase and sale concepts have no place—as the District Court explicitly found when it rejected one of California's earlier claims. J.A. 125-30. Second, the assets will be transferred onto AT&T's books of account at their historical "book" value, which the District Court found to be the correct valuation and cost standard for the transfers. J.A. 130-33.

[15]California's own regulatory practice confirms the irrelevance of sunk station handling costs to competitive CPE pricing. As California acknowledges (J.S. 12 n. 13), no portion of the station handling costs recorded in Account 232 is included in the prices at which it has authorized Pacific to sell CPE to telephone subscribers.

payers. This argument not only rests on a misunderstanding of these accounting entries, but also demonstrates why the District Court held that an assignment of all of Account 232 to AT&T would destroy the careful economic balance that the MFJ sought to preserve and needlessly destroy the investments made by the Bell System's three million shareholders. J.A. 339 n.18; see also *id.* at 323-28.

The reason that there are entries in Account 232 today is that regulatory commissions did not permit labor and other costs to be expensed and recovered at the time telephone installations were made—as they would have been in an unregulated business—until January 1, 1981. Although the Bell System's shareholders have recovered their costs for installations made after January 1, 1981, they have had a severe cost-recovery problem relating to the Account 232 investment that is on the BOCs' books and that pertains to the period before January 1, 1981. The FCC has adopted an equitable solution. It requires local exchange carriers, like the BOCs, to recover the Account 232 investment over a ten year period. The BOCs have been permitted to make this recovery, in large measure, from local ratepayers.[16] This reflects two facts. First, this sunk investment cannot be recovered by inflating CPE prices because of the intensely competitive markets for CPE that the FCC has created.[17] Second, it is the fairest mode of recovery because general ratepayers, as a class, benefitted from the expansion of telephone service that the previous artificially low installation charges made possible.

The effect of California's and New York's proposal would be to interrupt the process of cost recovery (now 30 percent completed)

[16]The BOCs are also free to recover these sunk investments from current users of inside wire. Under the Plan, this source of revenues will continue to be available to the BOCs.

[17]For example, AT&T could not recover the entire investment from the current users of inside wire or CPE customers because the total investment built up over years far exceeds the costs associated with current customers' use.

in midstream and renege on the regulatory obligation to permit the Bell System's three million shareholders to recover their capital. For these reasons, the assignment of the disputed portions of Account 232 to AT&T would upset the careful economic balance that the MFJ was designed to preserve, J.A. 339 n. 18—as well as violate its explicit terms and competitive objectives.

B. The Plan Provides For The Divestiture Of Pacific Telephone In A More Favorable Financial Condition Than The MFJ Requires.

California also objects to the Plan's provision that Pacific Telephone will be divested with a higher average cost of debt than the other BOCs. This claim is not only contrary to the plain terms and purposes of the MFJ, but ignores the reality that the amended Plan will leave Pacific in a far more favorable financial position than is required by even California's own construction of the MFJ.

Under the amended Plan, Pacific will be divested with a debt ratio of approximately 46.5%, which is substantially less than the approximately 50% debt ratio that Section VIII(H) of the MFJ permits, and an average cost of funded debt of approximately 9.5%. California's position is that the average cost of Pacific's debt must be reduced to 9.2% (J.S. 20 n.20). California reasons that this further reduction must occur before Pacific's debt will be of a "quality . . . representative of the average terms and conditions" of the Bell System's debt. See MFJ, §VIII(H), J.A. 184-85.

California's claims are meritless. Section VIII(H) does not require equalization of debt costs between Pacific and the other BOCs. In prescribing a higher debt ratio for Pacific than for the other BOCs, Section VIII(H) expressly recognizes that Pacific cannot be placed on an equal footing with the other companies. Pacific's average cost of debt is higher than the other BOCs for the same reason that the MFJ permits it to be divested with more debt: its adverse financial history and regulatory treatment by California (see p. 5 n. 3, *supra*; pp. 23-24, *infra*). The District

Court could not have authorized disparate treatment of Pacific in one clause of Section VIII(H) and then required complete equality in a second. See AT&T Response, 277-278.

But even if the first sentence of Section VIII(H) required the equalization of debt costs, the second sentence of the section —which California ignores—provides that "the Court may grant an exception to this requirement." J.A. 185. An exception is appropriate if it "can be shown that, with respect to a particular Operating Company, its own current debt provides a more equitable basis." J.A. 137 n. 321. Before the District Court, both AT&T and the United States took the position that if an exception was required to permit Pacific to be divested with its own cost of debt, the District Court should grant that exception in view of Pacific's unique financial and regulatory history.[18] In approving the Plan, the District Court unequivocally rejected California's claim that the MFJ requires a further reduction in Pacific's average cost of debt. J.A. 221-22 n. 64.

The District Court gave four separate reasons for rejecting California's position. Each is unassailable. First, the District Court found that any attempt to equalize Pacific's and the other BOCs' debt costs would require ratepayers in regions of the country that have experienced slow growth to subsidize telephone service for ratepayers in regions that have experienced high growth and in which the local telephone companies have had to borrow more often and more recently.[19] J.A. 221-22 n. 64. The subsidy California seeks would give Pacific lower debt costs than Southwestern Bell (9.4%), as to whose debt there is no dispute, and thus—perversely—would treat Pacific more favorably than

[18]See AT&T's Response, p. 298; Response Of United States, pp. 119, 122.

[19]California is in error when it asserts (J.S. 19) that equalizing the BOCs' cost of debt would not affect the other BOCs' finances or require substantial transfers among companies. Illinois Bell and Northwestern Bell, for example, would have their annual debt costs increased by approximately $10 million and $13 million in the first year alone; and overall, four of the seven regional companies would be net payers to the other three regions. See AT&T's Response, p. 279. The Staff of the Federal

another "Sun-belt" company that was not afflicted with the same history of unreasonable regulation and financial difficulty. Indeed, contrary to California's position, Pacific's chairman agreed to the divestiture of his company with a debt cost of 9.5% precisely because such costs were "in line with the other high growth 'Sun-belt' Bell Operating Companies." Second Supplemental Statement of Donald E. Guinn, p. 1 (April 7, 1983). As the District Court held, to further subsidize Pacific's debt costs in these circumstances would be manifestly unfair.

Second, the District Court found that such subsidies would lead to "new and continuing AT&T entanglements with the Operating Companies." J.A. 221-22 n. 64. The District Court correctly held that this would preserve the very financial integration of the Bell System that the MFJ was intended to end. *Id.*

Third, the District Court found that Pacific's adverse financial condition before divestiture was "due in large part to the action of California's regulators" (J.A. 137) and that "Pacific will be divested in as financially sound a condition as its prior history permits." J.A. 221-22 n. 64.[20] Contrary to California's arguments, the record demonstrates that, for more than a decade, the California commission steadily depressed Pacific's earning to levels that did not attract needed equity capital and that Pacific, consequently, was forced to rely increasingly on debt financing, which raised its cost of debt and raised its debt ratio from 48.6% in 1973 to 59.1% in 1980. This led to steady deterioration of

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Communications Commission agrees. It found that to divest Pacific Telephone with the Bell System's average cost of debt "would amount to a subsidy to [Pacific] and California consumers directly by other segments of the Bell System and indirectly by other Bell System customers." FCC Staff Analysis of AT&T Reorganization Plan, pp. 27-28 (February 11, 1983).

[20] *Accord*, FCC Staff Analysis of AT&T Reorganization Plan, pp. 27-28 (February 11, 1983) ("[Pacific's] debt ratio and cost of debt may be considered indicative of the condition of utilities in California . . . [Pacific's] financial difficulties, then, may simply reflect the risks a utility faces in California.").

Pacific's debt rating (from AAA in 1973 to A– in 1980).[21] See Sworn Statement of Donald E. Guinn, p. 9 (filed December 16, 1982). The MFJ manifestly was not intended to restore Pacific to the same balance sheet condition as those BOCs who have been subjected to less onerous regulatory treatment. To the contrary, Section VIII(H) recognizes that Pacific's debt situation differs from that of the other BOCs.

Finally, the District Court found that the Plan would, if anything, produce an impressive improvement in Pacific's financial condition, far in excess of that enjoyed by any other BOC. J.A. 221-22 n. 64.[22] Indeed, Pacific will be divested in a better financial position than is required by any interpretation of the MFJ, including California's. The following table, setting forth Pacific's total annual debt expense under four assumptions, illustrates this point.

Pacific Telephone's Debt Expense

Assumption	Debt Ratio	Total Debt (billions)	Cost of Debt	Annual Debt Expense (millions)
1. MFJ As Construed By Parties........	50.0%	$6.104	9.7%	$592
2. MFJ As Construed by California	50.0%	$6.104	9.2%	$562
3. Plan of Reorganization	46.5%	$5.676	9.5%	$540
4. California Proposal in this Court......	46.5%	$5.676	9.2%	$522

[21]During those years, the securities rating firms were unanimous in their view that the principal cause of Pacific's decline was unreasonable state regulation. See Duff & Phelps, Inc., "Review of Pacific Telephone," p. 1 (November 29, 1980) ("We would rank the California regulatory climate as about the worst among any that regulate the Bell System."); Standard & Poor's, *Fixed Income Investor*, p. 171 (October 22, 1977) ("regulatory treatment in California has been consistently below average for Pacific Telephone"). See also Moody's, *Bond Survey*, p. 524 (November 12, 1979).

[22]On March 28, 1983, Standard & Poor's, a securities rating firm, raised Pacific's debt rating from A– to A+, citing "the singular advantages that the company is expected to realize from divestiture." Standard & Poor's, *Credit Week*, p. 1942. Pacific was the only Bell System company to have its debt rating raised. *Id.*

Under the parties' construction of the MFJ (Assumption 1) Pacific could have been divested with 50 percent debt and its own cost of debt (9.7%), resulting in annual debt expenses of $592 million. Under California's construction of the MFJ (Assumption 2), Pacific could again have 50 percent debt, but with an average cost of debt of 9.2%, resulting in annual expenses of $562 million. However, Pacific's annual debt expenses under the Plan of Reorganization as approved by the District Court in the order appealed from (Assumption 3) will be only $540 million, some $22 million less than under California's own construction of the MFJ.[23] Under the proposal in California's Brief (p. 20 n.20), Pacific's debt expense would be lower still—$522 million (Assumption 4), but California assumes that it could insist on its reading of the debt cost provisions of the MFJ and also retain for Pacific a lower debt ratio than it acknowledges is provided by the MFJ. J.S. 19.

California cannot have it both ways. In the event the MFJ were construed to require that Pacific be divested with less than its own cost of debt, AT&T would withdraw that portion of the Plan providing Pacific a debt ratio lower than that required by the MFJ. In any event, however, because the Plan will result in a substantial improvement in Pacific's financial condition and leave Pacific better off than is required by any interpretation of the MFJ, it is apparent that California has neither legal nor practical grounds to complain that the Plan departs from the MFJ.

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[23]California acknowledges that the MFJ does not require Pacific to be divested with exactly the System average cost of debt (approximately 8.8%), which would treat it more favorably than several other BOCs. But even if Pacific were given debt costs of 8.8%, its annual debt expense (with the MFJ-prescribed debt ratio of 50%) would remain $540 million, leaving Pacific no better off than it will be divested under the Plan.

CONCLUSION

The District Court has shown that a trial court can expeditiously manage big antitrust cases and assure that the uncertainty that they create does not imperil vital national industries. The expedition of this appeal under the procedures Congress has established will enable the judicial system to continue to protect these public interests.

For the reasons stated, the appeals in this case should be decided by this Court before January 1, 1984. They are so lacking in merit that they should be affirmed summarily. This will remove the uncertainty that threatens the national telecommunications network while the Bell System completes the largest corporate reorganization in our nation's history.

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November 22, 1983

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